

Inflation

The main Central Banks of the world have been very relaxed about inflation. They have all argued that as lockdowns end there will be a brief uptick in inflation, which will then subside. The USA has been particularly strong on this view and has continued with massive dollar creation as well as ultra low interest rates to promote a stronger and quicker recovery. I have always thought they were overdoing it. The ECB has also persevered with a massive Euro creation programme, against more deflationary pressures in the deficit countries. It is having the predictable inflationary effect on the German economy whilst supplying some boost to the usually sluggish Italian one. The UK authorities started reining in earlier than the others and run the risk of slowing growth too much. As a very import dependent economy the UK will import a lot of inflation from the others unless sterling strengthens more.

Some at The ECB and Fed and the Bank of England economist are now saying that maybe inflation is going to go higher and last longer than their institutions have been saying. There is a surprise! What did they expect given the volume of dollars the Fed decided to tip into the system? What should Germany expect given the scale of Euro creation going on? The UK has to beware that fuel inflation is going to be fast thanks to the unacceptable reliance on imported and spot market energy. There will be wage growth as the UK sorts out years of low pay in areas from farming through driving to catering where wages were kept down by many migrants arriving to take the jobs. We face higher bills for transport, home heating and a range of goods that rely on gas for their manufacture.

The UK needs to work away at reducing its dependence on imports in general, and on imports with highly volatile day to day prices in particular. We have just seen a wild swing in the price of timber, where we import so much of what we need for housebuilding, for biomass power stations and for furniture. Given the passion to grow more trees, why dont we produce more of our own? We have just had to import a large amount of very expensive gas to combat a shortage of wind in our power system. It makes little sense to pay top prices for imported LNG, dragged around the world in diesel guzzling tankers when we could supply more of our own under long term sensibly priced contracts. Why do we not put in more gas storage while we are about it, so we can draw on stocks for any temporary high price shock?

The main Central Banks have talked themselves into a corner. If they now think they were too blase about inflation, they need to make sure their adjustments to the amount of money they create is not at the same time allied to rises in rates as this would likely tip economies into stagflation or even into recession. It's a tricky path. The Fed has most to do to decelerate from a very inflationary stance. The ECB has more excuse to wean itself off money creation more gently, as the southern economies are more sluggish. It will leave Germany suffering from a nasty inflation, needing to buy in a lot of foreign fossil fuel to keep the factories turning. The Bank of England has already announced an end to money creation.